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IN THE

Supreme Court of the United States

OCTOBER TERM, 1972.

No. 72-395

JOHN NUVEEN & CO., INC., A CORPORATION, WILLIAM FEIGELSON, STUART F. SILLOWAY, FRANK P. WENDT, RICHARD J. FRANKE, WALLACE D. FISK, KENNETH R. WAHLBERG, HORACE C. WHITEMAN, INVESTORS SYNDICATE OF AMERICA, INC., A CORPORATION, INVESTORS DIVERSIFIED SERVICES, INC., A CORPORATION, AND ALLEGHENY CORPORATION, A CORPORATION,

Petitioners,

vs.

HENRY T. SANDERS,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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Petitioners John Nuveen & Co., Inc., William Feigelson, Stuart F. Silloway, Frank P. Wendt, Richard J. Franke, Wallace D. Fisk, Kenneth R. Wahlberg, Horace C. Whiteman, Investors Syndicate of America, Inc., Investors Diversified Services, Inc. and Allegheny Corporation respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals

for the Seventh Circuit entered in this action on June 9, 1972.

OPINIONS BELOW.

The opinion of the United States Court of Appeals for the Seventh Circuit, not yet officially reported, is printed in an appendix to this Petition (A. 1). The court's opinion is unofficially reported at CCH Fed. Sec. L. Rep. ¶ 93,517 [Current Binder]. The District Court did not render an opinion in this case. The two orders of the United States District Court for the Northern District of Illinois, Eastern Division, from which petitioners appealed were entered on October 8, 1970 and on November 18, 1970, and are also printed in an appendix (A. 18, A. 19).

JURISDICTION.

The judgment of the United States Court of Appeals for the Seventh Circuit sought to be reviewed was entered on June 9, 1972. This petition for certiorari was filed within 90 days of that date. This Court's jurisdiction is invoked under 28 U. S. C. § 1254(1).

QUESTION PRESENTED.

Whether a promissory note with a maturity of only ninety days is a security subject to the provisions of the Securities Exchange Act of 1934 when Section 3(a)(10) of that Act specifically excludes from the Act's definition of "security" "any note . . . which has a maturity at the time of issuance of not exceeding nine months . . ."

STATUTORY PROVISION INVOLVED.

Following is the text of the statutory provision, the interpretation of which is at issue in this case; all other statutes, rules and regulations involved in this case appear in an appendix.

Section 3(a)(10) of the Securities Exchange Act of 1934, 15 U. S. C. § 78c(a)(10), provides:

> The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

STATEMENT OF THE CASE.

Plaintiff-respondent, Henry Sanders, filed his complaint on March 12, 1970, against John Nuveen & Co., Inc. ("Nuveen"), a broker-dealer, one of Nuveen's registered representatives, its directors and those claimed to be in a parent-subsidiary or control relationship with it. The gravamen of the complaint is that misrepresentations were allegedly made to plaintiff in connection with his purchase from Nuveen of short-term commercial paper in the form of a

ninety-day promissory note issued by Winter & Hirsch, Inc. ("Winter & Hirsch"), a finance company.* The note reads as follows:

WINTER & HIRSCH, INCORPORATED

$35,000.00 January 30, 1970 No. 7351

On April 30, 1970 for value received we promise to pay to the order of bearer the sum of Thirty Five Thousand and 00/100 Dollars payable at the principal office of First National Bank of Chicago

Not Negotiable Unless Countersigned

WINTER & HIRSCH, INCORPORATED

By /s/ SHELDON TUCKER
Counter Signature

By /s/ MILTON HIRSCH
Authorized Officer

The note was not paid at maturity. Respondent seeks rescission of his purchase or money damages on the ground that petitioners' alleged scheme to defraud him in connection with the sale of the Winter & Hirsch note violated Section 10(b) of the Securities Exchange Act of 1934 ("the 1934 Act"), 15 U. S. C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C. F. R. 240.10b-5. The complaint also charges that, in selling the note, petitioners violated Rules 2, 18 and 27 of Article III of the Rules of Fair Practice of the National Association of Securities Dealers, Inc. ("NASD"). The NASD is a voluntary association of securities brokers and dealers registered with the SEC pursuant to Section 15A of the 1934 Act, 15 U. S. C. § 78o-3. Federal jurisdiction of the Section 10(b) claim and the

* Respondent additionally purports to sue as the representative of the class of all persons who were purchasers of similar notes issued by Winter & Hirsch and sold by Nuveen.

claim under the NASD Rules is invoked under Section 27 of the 1934 Act,* 15 U. S. C. § 78aa.

On May 18, 1970, petitioners filed a motion in the District Court challenging, *inter alia*, the court's jurisdiction under the 1934 Act on the ground that the short-term promissory note purchased by respondent was not a "security" subject to the provisions of the 1934 Act, and its sale, therefore, could not violate the 1934 Act or the NASD Rules. The District Court denied petitioners' motion without opinion (A. 18).

Petitioners thereafter moved for reconsideration of that portion of their motion relating to the definition of "security" in the 1934 Act. The District Court declined to reconsider but amended its prior order and certified to the Seventh Circuit Court of Appeals, pursuant to 28 U. S. C. § 1292(b), the question whether commercial paper in the form of a conventional promissory note with a maturity of nine months or less is a "security" as defined in Section 3(a)(10) of the 1934 Act (A. 19-20).**

The Court of Appeals granted permission to appeal and, on June 9, 1972, held that the note purchased by respondent was a "security" under the Section 3(a)(10) definition. The court ruled that, although under the terms of the 1934

* Although not at issue in this petition, respondent also asserts a right to recover under Sections 12(2) and 17(a) of the Securities Act of 1933 (the "1933 Act"), 15 U. S. C. §§ 77*l* (2) and 77q(a), with jurisdiction being based upon Section 22 of the 1933 Act, 15 U. S. C. § 77v. In addition, he claims a right to recover damages from certain defendants based upon the liability of controlling persons provided in Section 20 of the 1934 Act, 15 U. S. C. § 78t.

** The District Court also ordered all references to a class action stricken from the complaint and certified, pursuant to 28 U. S. C. § 1292(b), the issues raised by that order. In Part II of its opinion the Court of Appeals for the Seventh Circuit reversed the District Court's ruling dealing with class action considerations. That portion of the Court of Appeals' decision is not challenged here.

Act "a note with a maturity not exceeding nine months [is] withdrawn from the application of the antifraud provisions of the act" (A. 6), the note purchased by respondent (with a maturity of only ninety days) nevertheless was a "security" subject to the antifraud provisions of the 1934 Act.

REASONS FOR GRANTING THE WRIT.

1. The Court of Appeals Committed Error in a Matter Which may Have a Widespread Detrimental Effect on this Country's Economy.

The Court of Appeals has committed egregious error of potentially far-reaching consequence to the public, American business and the securities industry in an important ruling with respect to what constitutes a "security" subject to the provisions of the Securities Exchange Act of 1934. A decision by this Court construing the exclusionary language of Section 3(a)(10) of the 1934 Act, 15 U. S. C. § 78c(a)(10), the section which defines "security" for purposes of the 1934 Act, will furnish needed guidance concerning whether or not short-term commercial paper falls within the scope of the 1934 Act.

Commercial paper* is unquestionably an important instrument in today's economy. As of the end of May, 1972, the amount of commercial and finance company paper outstanding in the United States exceeded $33 billion, $13 billion of which was placed directly by finance companies. *Federal Reserve Bulletin*, July, 1972, at A. 33. In all of 1971 new offerings of non-governmental stocks and bonds

* According to the Securities and Exchange Commission ("S. E. C."), "Commercial paper is a corporate short-term promissory note . . . sold either directly by the issuer (borrower) to the purchaser (lender), or by the issuer to a dealer who resells to the purchaser." *S. E. C. Staff Study of the Financial Collapse of the Penn Central Company*, File No. HO-482, at 549 (August 7, 1972) (hereinafter, *"Staff Study"*).

totalled $45 billion, whereas the total amount of commercial paper outstanding at the end of 1971 was $31 billion. *Id.* at A. 33, 48. "Some of the advantages [of commercial paper] are that the seller raises short-term cash at less cost than bank borrowings, the investor receives a higher rate of return than is otherwise possible through purchases of other short-term money market instruments, and commercial paper is also relatively easy to sell, ..." *Staff Study* at 552.

Since all concerned (the issuers, the securities industry and the S. E. C.) believed, until the decision below, that the 1934 Act was wholly inapplicable to commercial paper, the Court of Appeals' decision, if permitted to stand, will raise unforeseen problems of regulation under the 1934 Act. A decision by this Court on this significant issue is thus essential to clarify the status of commercial paper under the 1934 Act.

2. The Court of Appeals Erroneously Rejected the Plain and Unmistakable Meaning of the Statutory Provision Involved.

The Court of Appeals clearly erred in ignoring the well-recognized "plain meaning" principle of statutory interpretation.

Petitioners' motion in the District Court to dismiss all claims under the 1934 Act and the NASD Rules turned on whether short-term commercial paper is a "security" as that term is defined in Section 3(a)(10) of the 1934 Act. Since Section 3(a)(10) clearly and unequivocally excludes from the definition of "security" "any note . . . which has a maturity at the time of issuance of not exceeding nine months . . ." petitioners contended that the ninety day promissory note purchased by respondent from petitioner Nuveen was not a "security" under the 1934 Act.

The Court of Appeals recognized this as the plain meaning of Section 3(a)(10), for it acknowledged that ". . . only in the 1934 Act is a note with a maturity not exceeding nine months withdrawn from the application of the antifraud provisions of the act, . . ." (A. 6) and, of course, from the application of any other provision of the 1934 Act. Nevertheless, the Court of Appeals unaccountably refused to follow what the 1934 Act plainly says, adopting instead an unwieldly, if not unworkable, standard for determining which "notes with a maturity not exceeding nine months" are to be withdrawn from the application of the 1934 Act and which are not. (See Reason for Granting the Writ, Nos. 5 and 6, *infra*.)

This Court has expressed the "plain meaning" principle of statutory construction in the following terms:

> "For the ultimate question is what has Congress commanded, when it has given no clue to its intentions except familiar English words and no hint by the draftsmen of the words that they meant to use them in any but an ordinary sense." *Addison* v. *Holly Hill Fruit Products, Inc.*, 322 U. S. 607, 617-18 (1944).

Again, in *United States* v. *American Trucking Ass'ns, Inc.* 310 U. S. 534, 543 (1940), this Court wrote: "There is, of course, no more persuasive evidence of the purpose of a statute than the words by which the legislature undertook to give expression to its wishes."

In the statutory provision at issue, Section 3(a)(10) of the 1934 Act, Congress sought to give expression to its wishes (insofar as is here relevant) in the following words:

> "The term 'security' means any note . . .; but shall not include . . . any note . . . which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited."

While respondent's complaint referred to the instrument he bought as "short term commercial paper" (an expression not found in the statutory definition of "security"), the Court of Appeals acknowledged that it was a promissory note with a maturity not exceeding nine months. Certainly such instrument falls squarely within the above exclusionary language of Section 3(a)(10), composed as it is of "familiar English words."

In holding otherwise, the Court of Appeals did not point to a single word on the face of the statute to support its interpretation. Nor did the court uncover the slightest "hint by the draftsmen of the words [of Section 3(a)(10)] that they meant to use them in any but an ordinary sense." Indeed, the opinion below makes no mention whatever of the legislative history of the 1934 Act. (See pp. 14-15, *infra*). Instead, the court resorted to conjecture about Congress' unexpressed intentions and rewrote the statute to qualify markedly what Congress commanded. The decision of the Court of Appeals does violence to the "plain meaning" principle of statutory construction and should not be permitted to stand. As recently stated by this Court in another case under the 1934 Act:

> "[W]hatever the rationale of the proviso [in the statute], it cannot be disregarded simply on the grounds that it may be inconsistent with . . . the 'wholesome purpose' of the Act."
>
> • • • • •
>
> "[W]e are not free to adopt a construction that not only strains, but flatly contradicts the words of the statute." *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U. S. 418, 424, 427 (1972).

3. The Decision of the Court of Appeals is in Direct Conflict with Decisions in the Second Circuit.

In ignoring the clear and unmistakable language of Section 3(a)(10), the Seventh Circuit has placed itself in direct conflict with every court within the Second Circuit that has considered the same issue. Although not acknowledged by the Court of Appeals in this case, the Southern District of New York has consistently applied the objective standard provided in Section 3(a)(10) to determine whether a particular note is a "security" for purposes of the 1934 Act. Indeed, in three cases that court held that short-term notes were not securities under the 1934 Act, basing the decision solely on the fact that the maturity of the notes did not exceed nine months. *Investment Properties Int'l, Ltd.* v. *I. O. S., Ltd.*, CCH Fed. Sec. L. Rep. ¶ 93,011, at p. 90,739 (S. D. N. Y. 1971) [1970-71 Transfer Binder]; *Securities and Exchange Commission* v. *Fifth Avenue Coach Lines, Inc.*, 289 F. Supp. 3, 38 (S. D. N. Y. 1968), *aff'd*, 435 F. 2d 510 (2d Cir. 1970); *Superintendent of Insurance of the State of New York* v. *Bankers Life and Casualty Company*, 300 F. Supp. 1083, 1100 (S. D. N. Y. 1969), *aff'd*, 430 F. 2d 355 (2d Cir. 1970), *rev'd on other grounds*, 404 U. S. 6 (1971). In *Investment Properties Int'l, Ltd.* v. *I. O. S., Ltd., supra*, at p. 90,739 (S. D. N. Y. 1971), the court stated:

> "The $5,000,000 note, which plaintiffs claim constituted a security, had a maturity of six months, which was subsequently extended for an additional two months; *the [1934] Act expressly provides that a note having a maturity at time of issuance not exceeding nine months is not a 'security,'* 15 U. S. C. § 78(c)(a)(10)." (Emphasis added.)

Moreover, it would appear that the Court of Appeals for the Second Circuit has likewise approved the "plain mean-

ing" approach, rejected by the Court of Appeals in the case at bar, in applying Section 3(a)(10) of the 1934 Act. In *Movielab, Inc.* v. *Berkey Photo, Inc.*, 321 F. Supp. 806 (S. D. N. Y. 1970), *aff'd*, 452 F. 2d 662 (2d Cir. 1971), suit was brought alleging a violation of Rule 10b-5 in connection with the sale of several promissory notes of a maturity in excess of nine months. In holding that, under the plain meaning of Section 3(a)(10), the notes were "securities," the district court observed that:

> "Try as we may, we fail to detect in the 1934 Act *any grant of discretionary power to the court* to construe the term 'security' as including certain types of notes but not others." 321 F. Supp. at 809 (Emphasis added).

Its analysis indicated that the only appropriate inquiry was: (a) whether the instrument was a note, and (b) whether its maturity was longer than nine months. On appeal, the Second Circuit Court of Appeals affirmed *per curiam*, thus following the plain meaning of Section 3(a)(10).

4. The Decision of the Court of Appeals is in Direct Conflict with the S. E. C.'s Interpretation of the Statutory Provision Involved.

The Court of Appeals' decision is also in direct conflict with the S. E. C.'s interpretation of Section 3(a)(10). Notwithstanding the decision below, the S. E. C. continues to read Section 3(a)(10) as excluding *all* short-term commercial paper. Thus, as recently as August 3, 1972, the Commission's Chairman wrote in a letter to the Congress:

> "The antifraud provisions of the 1933 Act apply to the sale of securities exempt from regulation [registration?], *although commercial paper having a maturity*

> *up to 270 days is not a security for purposes of the Exchange Act of 1934.*" (Emphasis added.)*

Similarly, in the Commission's exhaustive *Staff Study* transmitted with the Chairman's letter it is unequivocally stated that:

> "In addition to the exemption from registration under the Securities Act of 1933, commercial paper maturing within 270 days also is exempt from all of the provisions of the Securities Exchange Act of 1934." *Staff Study* at 554. (Footnote omitted.)

The *Staff Study* views the Court of Appeals' decision in this case as aberrant. *Id.* at 554, n. 1.

It is well settled that the consistent construction of a statute by the administrative agency charged with its enforcement is entitled to great weight. See *FTC* v. *The Borden Company*, 383 U. S. 637, 640 (1966); *United States* v. *Republic Steel Corp.*, 362 U. S. 482, 490 (1960); *Brotherhood of Maintenance of Way Employees* v. *United States*, 366 U. S. 169, 179 (1961); *FTC* v. *Mandel Bros., Inc.*, 359 U. S. 385, 391 (1959); *Review Comm.* v. *Willey*, 275 F. 2d 264, 272 (8th Cir. 1960), *cert. denied*, 363 U. S. 827 (1960); see also 1 Davis, *Administrative Law Treatise* § 5.06 (1958) and cases cited. Where, as here, the administrative agency holds to its view despite the Seventh Circuit's decision to the contrary, it is most important that this Court resolve the obviously serious question as to the correctness of the decision below.

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* Letter from William J. Casey, Chairman, Securities and Exchange Commission, to Harley O. Staggers, Chairman, Special Subcommittee on Investigations, Committee on Interstate and Foreign Commerce, House of Representatives, p. 2, transmitting the Commission's *Staff Study*.

5. The Decision of the Court of Appeals Interpreting the Securities Exchange Act of 1934 is Based on an Incorrect Reliance upon Material Relative to the Securities Act of 1933.

Undeterred by the views of other courts the Court of Appeals found the note purchased by respondent subject to the 1934 Act, but only by adding to Section 3(a)(10) a qualification which Congress specifically omitted.

The court reached this bizarre result by looking, not to the 1934 Act or its legislative history, but to five other federal securities acts. The court below said:

> "In none of these five acts does there appear any language limiting in any way the broad definitions of 'security' or of 'note' . . . . Therefore *any* note, regardless of its nature, terms or conditions, is fully subject to whatever antifraud provisions are included in the five acts" (A. 6) (Emphasis in original).

The court then observed, correctly, that a note with a maturity not exceeding nine months is *withdrawn* from the application of the antifraud provisions of the 1934 Act. The court should have stopped there. Instead, it continued:

> "Since the same note is subject to the antifraud provisions of all the other securities acts, it becomes important to determine just what Congress intended to be exempt from the operation of the 1934 act" (A. 6-7).

To answer the question posed by it, the court turned to Section 3(a)(3) of the 1933 Act. This was clearly unwarranted, for the language of the two statutes is markedly different. Section 3(a)(10) of the 1934 Act flatly excludes all short-term notes from the definition of "security"; under the 1933 Act, all notes are treated as securities (see Section 2(1), 15 U. S. C. § 77b(1)), but Section 3(a)(3)

provides an exemption from registration for certain short-term notes. In pertinent part, Section 3(a)(3) provides:

> "Sec. 3.(a) Except as hereinafter expressly provided, the provisions of this title [the 1933 Act] shall not apply to any of the following classes of securities:
>
> • • • • •
>
> (3) Any note . . . *which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions,* and which has a maturity at the time of issuance of not exceeding nine months, . . ." (15 U. S. C. § 77c(a)(3); emphasis added).

None of the italicized language appears in Section 3(a)(10) of the 1934 Act and its exclusion of short-term notes is not limited by any language referring to "current transactions." Nevertheless, the Court of Appeals held that, insofar as short-term notes are concerned, the two provisions are synonymous, and engrafted the "current transactions" language onto the 1934 Act.

This was totally unjustified, for the legislative history of the 1934 Act establishes that Congress explicitly rejected the qualitative approach of the 1933 Act in favor of a more objective standard.

The first bill introduced in the House proposing a Securities Exchange Act contained a definition of "security" which excluded only those short-term obligations which arose "out of a current transaction or the proceeds of which have been or are to be used for current transactions," language identical to that used in Section 3(a)(3) of the 1933 Act. H. R. 8720, 73d Cong., 2d Sess. (1934). The definition of "security" in the bill passed by the House, H. R. 9323, was virtually identical to that in the earlier bill, except that the "current transactions" language had been omitted. Then, in the version of H. R. 9323

passed by the Senate, the "current transactions" qualification of H. R. 8720 was restored to the definition of "security." Finally, a conference committee agreed on a third compromise wording which was passed and signed into law.

In the final version of present Section 3(a)(10) of the 1934 Act the reference to "current transactions" had again been deleted from the exclusionary language of the definition of "security," providing thereby a more objective standard. It is thus clear that Congress, in passing the 1934 Act, intended to eliminate the "current transactions" qualification and enacted a definition of "security" expressly differing in that regard from the exemption language in the 1933 Act. Accordingly, material relating to the "current transactions" aspect of the 1933 Act was totally irrelevant to the question before the Court of Appeals.

6. The Court of Appeals' Unwarranted Excursion into the Securities Act of 1933 Raises Significant Problems in Connection with the Regulation of the Commercial Paper Market.

The Court of Appeals, having without justification added the "current transactions" qualification to the 1934 Act short-term note exclusion, misinterpreted that qualification. The decision, if not overturned, will interject substantial uncertainty as to the applicable regulatory pattern, where certainty prevailed before, and may be expected to adversely affect the commercial paper market.

In purporting to apply its redefinition of "security" under the 1934 Act to the instrument purchased by respondent, the Court of Appeals looked to S. E. C. Securities Act Release 33-4412, 26 F. R. 9158 (1961), 17 C. F. R. 231.4412 (the "Release"), which interprets only Section 3(a)(3) of the 1933 Act and relies solely on the language

and legislative history of that Act.* Focusing on the following language in the Release, the Court of Appeals held that the short-term note sold to plaintiff failed to meet any of its requirements:

> "The legislative history of the [1933] Act makes clear that section 3(a)(3) applies only to (1) prime quality negotiable commercial paper (2) of a type not ordinarily purchased by the general public, that is, (3) paper issued to facilitate well recognized types of current operational business requirements and (4) of a type eligible for discounting by Federal Reserve banks." [Numerals added by Court of Appeals, as quoted at A. 8.]

The court concluded that "it seems highly unlikely that the paper purchased by the plaintiff and members of his class is either prime quality or issued to facilitate current transactions or eligible for discounting by Federal Reserve banks" on the ground that, although Winter & Hirsch was thought to be financially sound when respondent purchased his note, the company later advised its creditors that it was bankrupt (A. 8).

The court has misinterpreted the Release and its significance.** Rather than establishing a series of four separate *conditions* to the availability of the 1933 Act exemption from registration, as the court clearly believes it does, the Release merely *describes* certain characteristics generally applicable to short-term commercial paper issued in current transactions. The Release, in effect, defines the meaning of the "current transactions" language of Section 3(a)(3) of

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* That the court erred in relying on this 1933 Act release to interpret the 1934 Act is established by the fact that the S. E. C., which promulgated the Release, has not used it to interpret the 1934 Act. *Supra*, p. 11.

** Petitioners do not concede that Release 33-4412 correctly sets forth the criteria for exemption under Section 3(a)(3). *Cf. SEC v. Perera Company, Inc.*, 47 F. R. D. 535, 536 (S. D. N. Y. 1969).

the 1933 Act, but it provides no basis for the conclusion, apparently adopted by the court, that every promissory note that fails to exhibit each of the characteristics enumerated therein not only loses its 1933 Act exemption but also is a "security" for purposes of the 1934 Act.* Indeed, the Release explicitly states that commercial paper issued by finance companies (such as Winter & Hirsch) is the "type of security which usually has been considered to fall within the terms of section 3(a)(3)" (and, therefore, even on the court's approach, to be excluded from the definition of "security" in the 1934 Act). Notwithstanding this clear statement by the S. E. C. in the Release, the court concluded that the Winter & Hirsch note in issue in this litigation was not excluded from the 1934 Act.

Moreover, in determining that the note in issue here was not excluded from the 1934 Act definition of "security" as expanded by it, the Court of Appeals based its analysis on facts which occurred or which came to light only *after* petitioner's sale of the note to respondent.** If a court can thus retrospectively determine the regulatory status of a particular item of commercial paper, dealers in commercial paper may be subject to liability no matter how extensive their investigation. Under all anti-fraud

* Further, while the Release states, as one of the characteristics of short-term paper exempt from the registration provisions of the 1933 Act, that the instrument is "of a type" not ordinarily purchased by the general public, the Court of Appeals looked to see how the particular notes in issue had, in fact, been marketed and, finding that "The paper was . . . obviously offered and sold to the general public" (A. 8), concluded that still another requirement of the Release had not been met. That commercial paper, exempt from the registration requirements of the 1933 Act, can be and is being sold to the general public was recently acknowledged by the S. E. C. See *Staff Study* at 558, 561.

** Although the District Court's ruling was on petitioners' motion to dismiss and the only competent evidence was, thus, the identification of the note, the Court of Appeals relied on unverified assertions of intervenors in the District Court concerning the Winter & Hirsch notes.

provisions of the federal securities laws, the extent of the seller's knowledge or investigation of the facts is relevant, as part of either plaintiff's case or defendant's affirmative case.* On the other hand, prima facie liability for the nonexempt sale of unregistered securities is absolute.** If by hindsight a court can determine that the exemption from registration normally available to commercial paper was not available, then a questionable antifraud claim, such as the one now before the Court, will become a certain claim for the sale of unregistered securities. Indeed, if the approach of the Court of Appeals in this case is generally applied, all rating and evaluation of commercial paper and, indeed, all sales of unregistered commercial paper will be at the risk of the sellers, who will become virtual guarantors.

Having misinterpreted and misapplied the Release, the Court of Appeals then developed still another prerequisite to exclusion—the investment goal of the purchaser:

> "When a prospective borrower approaches a bank for a loan and gives his note in consideration for it, the bank has purchased commercial paper. But a person who seeks to invest his money and receives a note

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* In this action, plaintiff relies on Rule 10b-5 under the 1934 Act and Sections 12(2) and 17(a) of the 1933 Act. As to the relevance of the mental state under Rule 10b-5, see, *e.g.*, *Dasho* v. *The Susquehanna Corporation*, 461 F. 2d 11, 29-30 at n. 45 (7th Cir. 1972), *cert. denied*, 92 S. Ct. 2496 (1972); *Shemtob* v. *Shearson, Hammill & Co., Inc.*, 448 F. 2d 442, 445 (2d Cir. 1971). Section 12(2) includes the affirmative defense that the defendant "did not know, and in the exercise of reasonable care could not have known" of the untruth or omission with which he is charged. If Section 17(a) supports a private claim for damages, the state of mind requirement would at least be as great as that under Rule 10b-5 or Section 12(2). As to the relevance of state of mind under the other antifraud provisions, see Section 11(b)(3) of the 1933 Act, 15 U. S. C. § 77k(b)(3), and Sections 9(e) and 18(a) of the 1934 Act, 15 U. S. C. §§ 78i(e) and 78r(a), respectively.

** 3 Loss, *Securities Regulation* 1693 (2d ed. 1961).

> in return for it has not purchased commercial paper in the usual sense. He has purchased a security investment" (A. 10).

However, nothing in the legislative history suggests that the purpose for which commercial paper is purchased is at all relevant to whether it should be exempt from the registration requirements of the 1933 Act or excluded from the 1934 Act. The applicability of the exemption and exclusion depend upon the type of instrument, not the buyer's purpose; their availability properly depend on facts regarding the issuer, not the buyer. If this additional test prevails, then issuers of and dealers in commercial paper—of what was thought to be commercial paper—will have to investigate the purpose of every purchase made from them before they can be assured as to the regulatory status of the transaction.

Once again the S. E. C.'s recent *Staff Study* demonstrates the misconception under which the Court of Appeals was proceeding. Notwithstanding its exempt status, commercial paper is indeed purchased as an investment:

> "Most investors [purchasers of commercial paper] have only one thing in common: funds to invest for a short period of time with the smallest possible risk and the maximum return. Since treasury bills may not fit purchasers' maturity needs and both bank CD's and treasury bills have a lower interest rate, purchasers turn to commercial paper." *Staff Study* at 558.

The usefulness of commercial paper lies in its short maturities. This permits companies to finance part or all of their operations in such a way as to take advantage of fluctuating interest rates and obtain funds only as needed. For these reasons commercial paper is often sold on a continual, or at least recurrent, basis in varying amounts and at interest rates which vary daily. This makes it impractical to register commercial paper under the 1933 Act prior to sale. It is clear that if registration were required because

the Section 3(a)(3) exemption were not available the important commercial paper market could well be seriously restricted.

7. The Decision of the Court of Appeals is Based on Inapposite Supreme Court Cases.

The Court of Appeals' wholesale incorporation into the 1934 Act definition of "security" of language and concepts from other securities laws appears to have been prompted by an overly zealous reading of Supreme Court opinions dealing with the construction of federal securities legislation. This should be corrected.

The question presented by this petition has not yet been decided by this Court. However, the Court of Appeals wrote:

> "The Supreme Court has sanctioned, in interpreting the definition of a security in the 1934 act, recourse to the definitions of security in the Securities Act of 1933 (*Tcherepnin* [v. *Knight*, 389 U. S. 332] at 335-36, 338 [1967]) and in the 'companion legislative enactments.' *Affiliated Ute Citizens* v. *United States*, 40 U. S. L. W. 4448, 4455 (1972)." (A. 5.)

Since *Tcherepnin* involved portions of the respective definitions which are virtually identical, rather than the disparate provisions here involved, "recourse" in that case to the 1933 Act definition of "security" was warranted. In addition, this Court was not concerned in that case with either the exclusion in the 1934 Act definition of "security" or the 1933 Act registration exemption, let alone with short-term notes. The *Affiliated Ute Citizens* case did not interpret a definition of "security" at all. Finally, although the decisions of this Court, cited by the Court of Appeals, did advance a flexible approach to construing securities laws, none provide support for the Court of Appeals' disregard of a plainly worded statutory exclusion such as that for short-term notes in Section 3(a)(10) of the 1934 Act.

definition of security at all, and neither it nor any of the other Supreme Court cases cited by the court below, while advancing a flexible approach to construing securities laws, provides support for the Court of Appeals' disregard of a plainly worded provision.

CONCLUSION.

For the reasons given we pray that the writ be granted.

Respectfully submitted,

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APPENDIX A.

OPINION AND ORDER OF THE COURT OF APPEALS; ORDER AND AMENDED ORDER OF THE DISTRICT COURT.

IN THE UNITED STATES COURT OF APPEALS
for the Seventh Circuit

September Term, 1971—January Session, 1972

Nos. 71-1163, 71-1164
HENRY T. SANDERS,
Plaintiff-Appellant,
v.
JOHN NUVEEN & Co., INC.,
Defendants-Appellees.

HENRY T. SANDERS,
Plaintiff-Appellee,
v.
JOHN NUVEEN & Co., INC.,
Defendants-Appellants.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.
No. 70 C 597
J. SAM PERRY, Judge.

Argued January 26, 1972—Decided June 9, 1972

Before HASTINGS, *Senior Circuit Judge,* and KILEY and SPRECHER, *Circuit Judges.*

SPRECHER, *Circuit Judge.* This appeal raises two principal issues: (1) whether promissory notes with a maturity not exceeding nine months but offered to the public as an

investment are "securities" within the definition of the Securities Exchange Act of 1934 and (2) whether the representative of an antagonistic class can properly intervene and assume representation of the plaintiff class without notice to the members of that class?

Plaintiff, Henry T. Sanders, filed his complaint on March 12, 1970, against John Nuveen & Co., Inc., a broker-dealer in securities, one of its registered representatives, and its directors and controlling persons. The complaint charged defendants with a scheme and artifice to defraud plaintiff and others in his class by selling to them short-term commercial paper issued by Winter & Hirsch, Inc. but owned by Nuveen. Plaintiff's claim was based on the Securities Act of 1933, 15 U. S. C. § 77a, the Securities Exchange Act of 1934, 15 U. S. C. § 78a, Rule 10b-5, 17 C. F. R. § 240.10b-5, and the Rules of Fair Practice of the National Association of Securities Dealers.

On May 18, 1970, the defendants moved to strike certain allegations of the complaint and expressly attacked the class-action aspects of the complaint. They also challenged the jurisdiction of the court under the 1934 act on the ground that the short-term commercial paper involved was not a "security." The district court denied the motion to strike on October 8, 1970.

On October 19, 1970, the plaintiff served on defendants his motion, to be presented to the court on November 2, requesting that a notice be sent to the class represented by plaintiff as provided in Rule 23(c)(2) of the Federal Rules of Civil Procedure. The class suggested was "all persons who were purchasers of short-term commercial paper which was issued by Winter & Hirsch, Incorporated, and sold by John Nuveen & Co., Inc."

On October 29, the First National Bank of Chicago and the Harris Trust and Savings Bank sought leave to inter-

vene on their own behalf and "on behalf of certain creditors of Winter & Hirsch, Incorporated."

The motion to intervene stated that on March 11, 1970 (one day prior to the filing of plaintiff's suit), the creditors of Winter & Hirsch had met and had elected an informal creditors' committee. The creditors' committee, working with the management of Winter & Hirsch, had negotiated with Mercantile Financial Corp. a purchase agreement relating to substantially all of Winter & Hirsch's loan receivables; the agreement required certain waivers by holders of long-term debt obligations. The motion also stated that the creditors' committee had developed a liquidating trust to become effective upon the execution and delivery of a "Consent and Agreement" by all the lenders of funds to Winter & Hirsch, including plaintiff.

At the same time that they sought to intervene, the two banks also moved that the district court enter an order pursuant to Rule 23(d) directing the plaintiff to execute a "Consent and Agreement" on a stipulation by all parties that its execution would "not constitute a dismissal or compromise under Federal Rule 23(e)."

The banks' motions were not accompanied by any pleadings in the Rule 7(a) sense of complaints or answers, or by documents seeking to adopt pleadings already on file.

Plaintiff's counsel were notified by telephone the night before that the banks were going to appear before the district judge on October 29; counsel were given copies of the motions at 10 a.m. on the 29th as court convened. The court continued the matter to 1:45 p.m., at which time the plaintiff filed written objections to the motions. The court heard argument by the parties but no evidence in the afternoon, at which time the court requested the parties to attempt to agree on an order. The banks delivered a proposed form of order to plaintiff's counsel at 4 p.m. and advised them that

they would reappear in court at 4:30. Plaintiff's counsel replied that they would need some time to read the proposed order and confer with their client. They appeared at the courtroom at 4:50 to learn that the judge had entered an order at 4:35 and left the bench. The order permitted the banks to intervene and directed the plaintiff to sign the stipulation and consent by 5 p.m. or the class aspects of the complaint would be stricken. The intervention was allowed on behalf of creditors including all members of the class which plaintiff sought to represent.

The plaintiff filed a motion to vacate the October 29 order, which motion was denied on November 5, 1970. The court's reason was "the plaintiff's expressed opposition to all members of the class by refusing to join in a compromise that all of them have agreed to enter into." On its own motion, the court found that "there may be a class described in the cause without counsel," whereby he ordered that "said cause . . . proceed as an individual complaint."

On November 17, 1970, the district judge certified pursuant to 28 U. S. C. § 1292(b) the questions (1) whether it was error to permit the banks to intervene, (2) whether it was error to find that the plaintiff did not represent the class and (3) whether it was error to strike the class aspects of the complaint. On the motion of defendants, the court on the following day amended its prior order denying defendants' motion to strike, to certify another question under 28 U. S. C. § 1292(b): whether the commercial paper upon which the complaint is predicated is a "security" as defined in section 3(a)(10) of the Securities Exchange Act of 1934.

This court granted leave to appeal on all four questions on December 21, 1970.

We consider first the threshold question of whether a security under the 1934 act is involved.

I

Federal securities legislation enacted for the purpose of avoiding frauds is to be construed "not technically and restrictively, but flexibly to effectuate its remedial purposes." *S. E. C.* v. *Capital Gains Research Bureau, Inc.*, 375 U. S. 180, 195 (1963).

Particularly, the definition of a security "embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." *S. E. C.* v. *W. J. Howey Co.*, 328 U. S. 293, 299 (1946). "[I]n searching for the meaning and scope of the word 'security' in the [Securities Exchange] Act [of 1934], form should be disregarded for substance and the emphasis should be on economic reality." *Tcherepnin* v. *Knight*, 389 U. S. 332, 336 (1967).

The Supreme Court has sanctioned, in interpreting the definition of a security in the 1934 act, recourse to the definitions of security in the Securities Act of 1933 (*Tcherepnin* at 335-36, 338) and in the "companion legislative enactments." *Affiliated Ute Citizens* v. *United States*, 40 U. S. L. W. 4448, 4455 (1972).

An examination of the six basic federal securities acts is relevant and revealing.

The Securities Act of 1933,[1] the Trust Indenture Act of 1939,[2] the Investment Company Act of 1940,[3] and the Investment Advisers Act of 1940,[4] all define a security as follows: "The term 'security' means any note, . . . evidence of indebtedness, . . . investment contract, . . . or, in general,

1. Section 2(1). 15 U. S. C. § 77b(1).
2. Section 303(1). 15 U. S. C. § 77ccc(1).
3. Section 2(a)(36). 15 U. S. C. § 80a-2(a)(36).
4. Section 202(a)(18). 15 U. S. C. § 80b-2(a)(18).

any interest or instrument commonly known as a 'security'. . . .'"[5] The Public Utility Holding Company Act of 1935[6] definition differs slightly: "'Security' means any note, . . . investment contract, . . . or, in general, any instrument commonly known as a 'security'. . . ."[7]

In none of these five acts does there appear any language limiting in any way the broad definitions of "security" or of "note," "evidence of indebtedness," "investment contract" or "instrument commonly known as a security." Therefore *any* note, regardless of its nature, terms or conditions, is fully subject to whatever antifraud provisions are included in the five acts.

Only in the Securities Exchange Act of 1934 is there an exception to the broad definition of a security; it reads:[8]

> "The term 'security' means any note, . . . investment contract, . . . or in general, any instrument commonly known as a 'security'; . . . but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited."

Therefore only in the 1934 act is a note with a maturity not exceeding nine months withdrawn from the application of the antifraud provisions of the act, section 10(b) and Rule 10b-5. Since the same note is subject to the

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5. Mr. Justice Blackman, in commenting upon the language of Rule 10b-5 said that proscriptions of the securities laws, by "repeated use of the word 'any' are obviously meant to be inclusive." *Affiliated Ute Citizens* v. *United States*, 40 U. S. L. W. 4448, 4455 (1972).

6. Section 2(a)(16). 15 U. S. C. § 79b(a)(16).

7. In *Tcherepnin* v. *Knight*, 389 U. S. 332, 344 (1967), the Supreme Court found no "controlling significance" in the fact that the term "evidence of indebtedness," which was included in the 1933 act, was omitted from the 1934 act.

8. Section 3(a)(10). 15 U. S. C. § 78c(a)(10).

antifraud provisions of all the other securities acts, it becomes important to determine just what Congress intended to be exempt from the operation of the 1934 act.

Although all notes are subject to the antifraud provisions of the other acts, some of those acts exempt short-term commercial paper from registration or other requirements.[9] Plaintiff urges that the meaning given to short-term obligations in other securities legislation, particularly the 1933 act, be applied to the definition found in the 1934 act. The 1933 act exempts from registration,[10] but not from antifraud sanctions,[11] "[a]ny note, draft, bill of exchange, or banker's acceptance which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions," and which has a maturity not exceeding nine months.

The Securities and Exchange Commission has interpreted the 1933 act's exemption of short-term commercial paper as embodying four requirements:[12]

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9. *Tcherepnin* v. *Knight*, 389 U. S. 332 (1967) (withdrawable capital shares of savings and loan association subject to Rule 10b-5 although exempt from registration). *See also* Opinion of Director of Trading & Exchange Division of S. E. C., Release No. IA-40, 11 F. R. 10997 (1945).

10. Section 3(a)(3). 15 U. S. C. § 77c(a)(3).

11. Section 17(c). 15 U. S. C. § 77q(c).

12. Release No. 33-4412, 17 C. F. R. § 231.4412 (1961) (numerals added). The release emphasized the prime quality of the paper intended to be exempted and stated that the exempted items are "composed of assets easily convertible into cash and are comparable to liquid inventories of an industrial or mercantile company." During the hearings on the 1933 act, commercial paper discountable by Federal Reserve banks was described as having "a record of safety only second to Government bonds" and as being the basis of our currency. Hearings on S. 875 Before the Senate Comm. on Banking and Currency, 73rd Cong., 1st Sess. at 94, 95 (1933). It is significant that section 3(a)(10) of the 1934 act exempts "currency" from the definition of security. 15 U. S. C. § 78c(a)(10).

> "The legislative history of the Act makes clear that section 3(a)(3) applies only to (1) prime quality negotiable commercial paper (2) of a type not ordinarily purchased by the general public, that is, (3) paper issued to facilitate well recognized types of current operational business requirements and (4) of a type eligible for discounting by Federal Reserve banks."

Although no evidence has been heard in this case, the record shows that the commercial paper purchased by the plaintiff was dated January 30, 1970, and that "Winter & Hirsch was engaged in the business of making loans until in or about February 1970, when it advised its creditors of its precarious financial condition and ceased to make any further payments on any of its obligations for borrowed money." At that time it had assets of $12.5 million and liabilities of more than $36 million. Thus, because of the company's insolvency, it seems highly unlikely that the paper purchased by the plaintiff and members of his class is either prime quality or issued to facilitate current transactions or eligible for discounting by Federal Reserve banks.

The record further shows that the commercial paper purchased by the plaintiff was "placed through John Nuveen & Co." and bought by 42 purchasers, including the plaintiff, in the aggregate face amount of $1,661,500. The paper was therefore obviously offered and sold to the general public; indeed, it was characterized in the issuer's financial statements as "short term open market" paper.[13] The notes fail to meet any of the S. E. C.'s four requirements for exemption.

13. H. R. Rep .No. 85, 73rd Cong., 1st Sess., 15 (1933) stated in discussing the bill, which became the Securities Act of 1933, "Paragraph (3) exempts short-term paper of the type available for discount at a Federal Reserve bank and of a type which rarely is bought by private investors."

If, as the Supreme Court has admonished, "form should be disregarded for substance" and economic reality emphasized, it is reasonably clear that plaintiff and his class purchased the kind of "security" in regard to which the securities acts were intended to offer protection against fraud, misrepresentation and non-disclosure.[14] Five of those acts expressly did so. We believe Congress intended to protect against fraud the purchasers of securities such as those involved here under the 1934 act as well.[15]

The court in *Anderson* v. *Francis I. duPont & Co.*, 291 F. Supp. 705, 708-09 (D. Minn. 1968), reached the same conclusion. Promissory notes of less than nine months' maturity were given in exchange for investments in defendant's commodities market scheme. The court held the 1934 act applicable to the notes.

Our conclusion is further supported by Congress' characterization of short-term commercial paper in exempting it from certain provisions (but not antifraud provisions) of two of the other securities acts. Certain provisions of the Public Utility Holding Company Act of 1935 do not apply to a note or draft with a maturity not exceeding nine months, provided that it "is not part of a public offering" and aggregates not more than 5 percent of the other securities of the company.[16] The Investment Company Act of 1940 defines "short-term paper" as paper with a maturity

14. Forty of the purchasers invested from $3,000 to $100,000 and the other two invested $150,000 and $205,000. In *Tcherepnin*, the Supreme Court, noting that small investors were involved, said (389 U. S. at 345): "Policy considerations lead us to conclude that these petitioners are entitled to the investor protections afforded by the Securities Exchange Act."

15. Professor Loss equates the 1933-act meaning of security with that of the 1934 act to some extent: "Short-term notes of the type which are *exempted from registration* under the Securities Act by § 3(a)(3) are *excluded from the definition of 'security'* in the Exchange Act." 2 Loss, Securities Regulation 796 (1961).

16. Section 6(b). 15 U. S. C. § 79f(b).

not exceeding nine months "and such other classes of *securities, of a commercial rather than investment character,* as the Commission may designate by rules and regulations."[17]

In other words, when Congress spoke of notes with a maturity not exceeding nine months, it meant commercial paper, not investment securities.[18] When a prospective borrower approaches a bank for a loan and gives his note in consideration for it, the bank has purchased commercial paper. But a person who seeks to invest his money and receives a note in return for it has not purchased commercial paper in the usual sense. He has purchased a security investment. *Cf. City National Bank* v. *Vanderboom,* 290 F. Supp. 592, 608 (W. D. Ark. 1968), *aff'd,* 422 F. 2d 221 (8th Cir.), *cert. denied,* 399 U. S. 905 (1970).

Although further evidence may be necessary to determine the issue, the allegations of the complaint together with additional information in the record on appeal indicate a strong possibility that Nuveen's arrangements with the plaintiff and with the members of plaintiff's class also constitute investment contracts. Apparently, Nuveen purchased the Winter & Hirsch paper at a discount and resold it to the 42 purchasers at a different rate of discount in order to realize a profit. At least in the plaintiff's case (and evidence would be necessary to determine in how many other cases), the use of plaintiff's funds for the short-term notes was a temporary arrangement "in lieu of tax exempt municipal bonds and . . . the money so invested would be available for purchase of tax exempt bonds at an early date."

It seems likely that the arrangements between Nuveen

17. Section 2(a)(38). 15 U. S. C. §80a-2(a)(38) (emphasis added).

18. Although some of the paper placed through Nuveen went to banks, the large majority of purchasers were individuals.

and plaintiff constituted "the placing of capital or laying out of money in a way intended to secure income or profit from its employment." *S. E. C.* v. *W. J. Howey Co.*, 328 U. S. 293, 298 (1946). *See also* 1 Loss, Securities Regulation 489-91 (1961); *Anderson* v. *Francis I. duPont & Co.*, 291 F. Supp. 705, 708 (D. Minn. 1968).[19]

However, in view of our interpretation that the instruments involved here are securities since they are notes not covered by the exemption, we do not need to determine whether as a matter of fact the arrangements between the parties also constituted investment contracts.

II.

The remaining three issues certified for determination can be considered together: whether the allowance of the bank's intervention was proper and whether the district court erred in finding that the plaintiff did not represent the class and in striking the class allegations from the complaint.

The record discloses that the two intervening banks are holders of "short term senior debt" as banks extending lines of credit, First National Bank of Chicago in the amount of $1,750,000 and Harris Trust and Savings Bank in the amount of $1,000,000. As such, neither bank would come within the class suggested by the plaintiff, namely, all persons who were purchasers of short-term commercial paper which was issued by Winter & Hirsch and sold by John Nuveen & Co. The plaintiff has alleged in addition, and the banks have not denied, that each bank is

19. Professor Bromberg has noted, "Even if short term notes are effectively excluded from the definition of security, their use in connection with an investment contract or other transaction constituting a security does not immunize the transaction from the antifraud rules." Bromberg, *Securities Law, Fraud, SEC Rule 10b-5*, § 4.6(321) (1971).

also the holder or owner of substantial amounts of long-term debt of Winter & Hirsch, which is described in the liquidating trust agreement as "junior subordinated debt."

Since it is acknowledged by all parties that Winter & Hirsch is insolvent and unable to pay its debts as they mature, it is reasonably certain that the creditors will eventually receive less than the amounts which they are owed. It follows that any advantage obtained by one class of creditors will cause other classes of creditors to be disadvantaged. The two intervening banks, as members of at least two classes of creditors other than the class represented by the plaintiff, are *per se* antagonistic to the plaintiff's class. It is obvious that the banks can neither represent the plaintiff's class nor strengthen the representation of plaintiff's class by intervening.

The portions of Rule 23(d) pertaining to intervention in class actions are intended to strengthen the adequacy of representation of the class.[20] The Advisory Committee's Note to Rule 23 emphasizes, "Subdivision (d) is concerned with the fair and efficient conduct of the action" through supplementary notice to members of the class and by strengthening the class where necessary.[21]

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20. Fed. R. Civ. P. 23(d): "In the conduct of actions to which this rule applies, the court may make appropriate orders: . . . (2) requiring, for the protection of the members of the class or otherwise for the fair conduct of the action, that notice be given in such manner as the court may direct to some or all of the members of any step in the action, or of the proposed extent of the judgment, or of the opportunity of members to signify whether they consider the representation fair and adequate, to intervene and present claims or defenses, or otherwise to come into the action; (3) imposing conditions on the representative parties or on intervenors. . . ."

21. Advisory Committee Note to Rule 23 states in part: "Subdivision (d)(2) sets out a non-exhaustive list of possible occasions for orders requiring notice to the class. . . . [The] mandatory notice pursuant to subdivision (c)(2), together with any discretionary notice which the court may find it advisable to give under subdivision (d)(2), is designed to fulfill requirements of due

Since the district judge did not provide for any notice to the plaintiff class, it was clearly improper for him to permit the two banks, with their conflicting and antagonistic interests, "to intervene herein, on their own behalf and on behalf of those creditors of Winter & Hirsch, Incorporated set forth in Exhibit B to the Motion to Intervene." That exhibit listed among others, the members of plaintiff's suggested class: all persons who were purchasers of short-term commercial paper which was issued by Winter & Hirsch and sold by Nuveen. The effect of such intervention was to weaken the plaintiff class and possibly to strip from its advantages which it held against other classes of creditors, including the classes of which the two intervening banks are members. The attempt to include some protective language in the intervention order purported to represent the class, the plaintiff's cause virtually collapsed. No intervention could be accomplished without prior full and fair notice to the members of plaintiff's class and, of course, such notice could not be given until the court determined whether plaintiff's suggested class fulfilled the requirements of Rule 23(a) and (b)(3).[22]

If in fact the banks had procured the "consent and agreement" of all the members of plaintiff's class other than plaintiff, such consent and agreement was meaningless within the context of this cause of action unless procured after full and fair notice and disclosure to the members of the class, under the supervision of the court,

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process to which the class action procedure is of course subject. . . . Subdivision (d)(3) reflects the possibility of conditioning the maintenance of a class action, *e.g.*, on the strengthening of the representation . . . ; and recognizes that the imposition of conditions on intervenors may be required for the proper and efficient conduct of the action."

22. *Hohmann* v. *Packard Instrument Co.*, 399 F. 2d 711 (7th Cir. 1968).

of their possible rights in this cause, of the conflicting interests of other classes of creditors, including the banks, and of the surrender of certain rights by consenting and agreeing to the liquidating trust arrangement. The purpose of the mandatory notice and disclosure requirements of Rule 23(c)(2) is to advise all class members of their rights and privileges under the close supervision of the court.

This is not to say that the banks could not intervene under any circumstances. Once the court has determined whether the plaintiff's suggested class satisfies the requirements of Rule 23(a) and (b)(3), and once members are notified under Rule 23(c)(2), the banks may seek to intervene under Rule 24(a)(2). They would petition not as representatives of the plaintiff's class, but as applicants who claim "an interest relating to the property or transaction which is the subject of the action and [are] so situated that the disposition of the action may as a practical matter impair or impede [their] ability to protect that interest. . . ." At that point, the court may determine that the members of plaintiff's class are entitled to supplementary notice under Rule 23(d)(2).[23]

If the banks seek to intervene under those circumstances, Rule 24(c) and sound judicial administration require that their motion to intervene "shall state the grounds therefor and shall be accompanied by a pleading setting forth the claim or defense for which intervention is sought." The pleading should be one of those described in Fed. R. Civ. P. 7(a) so that all parties understand the position, claims and nature of relief sought by the prospective intervenors.

Once the due process requirements of Rule 23 are

23. In order to expedite the proceedings, the court may determine that it is feasible to combine the mandatory notice under Rule 23(c)(2) with the discretionary notice under 23(d)(2).

satisfied by full and fair notice to all members of any class or classes or subclass or subclasses determined by the court, the court may then "make appropriate orders . . . determining the course of proceedings."[24]

The basic error in these proceedings was permitting two members of antagonistic classes to intervene on behalf of another (plaintiff's) class and not only to purport to take over plaintiff's case but in effect to introduce an entirely different cause of action in which all parties but plaintiff had previously "consented" without notice and disclosure under court supervision of their rights and options. The error was compounded by attempting to coerce the plaintiff to add his consent.

In No. 71-1163 we reverse the orders which allow intervention, which find the plaintiff not representative of the class alleged in the complaint and which strike allegations in the complaint as to class action. In No. 71-1164, we affirm the order denying the motion to strike certain allegations of the complaint, because the commercial paper on which the plaintiff predicated his claim for relief is a "security" under the Securities Exchange Act of 1934. The case is remanded for further proceedings consistent with this opinion.

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24. Fed. R. Civ. P. 23(d)(1). It should also be noted that not only may a class be divided into subclasses if that course seems advisable to the trial court (Rule 23(c)(4)), but also that any order fixing classes or subclasess "may be conditional, and may be altered or amended before the decision on the merits" (Rule 23(c)(1)).

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

June 9, 1972

Before
Hon. JOHN S. HASTINGS, *Senior Circuit Judge*
Hon. ROGER J. KILEY, *Circuit Judge*
Hon. ROBERT A. SPRECHER, *Circuit Judge*

No. 71-1163, 71-1164
HENRY T. SANDERS,
Plaintiff-Appellant,
vs.
JOHN NUVEEN & Co., INC.,
Defendants-Appellees.

HENRY T. SANDERS,
Plaintiff-Appellee,
vs.
JOHN NUVEEN & Co., INC., ET AL.,
Defendants-Appellants.

Appeal from the United States District Court for the Northern District of Illinois Eastern Division.

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that orders of the United States Court for the Northern District of Illinois, Eastern Division, which al-

low intervention, which find the plaintiff not representative of the class alleged in the complaint and which strike allegations in the complaint as to class action, being the judgments appealed from in appeal number 71-1163, Henry T. Sanders, Plaintiff-Appellant v. John Nuveen & Co., Inc., Defendants-Appellees, be and the same are hereby Reversed.

IT IS FURTHER ORDERED AND ADJUDGED BY THIS Court that in appeal number 71-1164, Henry T. Sanders, Plaintiff-Appellee v. John Nuveen & Co., Inc., Defendants-Appellants, the judgment of the said District Court denying the motion to strike certain allegations of the complaint, be and the same is hereby Affirmed.

IT IS FURTHER ORDERED that this case be and the same is hereby Remanded to the said District Court for further proceedings consistent with the opinion of this Court filed this day.

IT IS FURTHER ORDERED and adjudged by this Court that the costs in both appeals be taxed in favor of Plaintiff Henry T. Sanders and against Defendants John Nuveen & Co., Inc., et al.

IN THE UNITED STATES DISTRICT COURT
For the Northern District of Illinois
Eastern Division.

HENRY T. SANDERS,
Plaintiff,
vs.
JOHN NUVEEN & Co., INC., et al.,
Defendants.

No. 70 C 597

ORDER

The Court has examined and considered the Motion to Strike Certain Allegations of the Complaint filed by Defendants wherein and whereby they request that the class allegations of the complaint be stricken; that all claims under the Securities Exchange Act of 1934, which are those alleging violations of Section 10(b) (15 U. S. C. 77j(b)) and 20 (15 U. S. C. 78t) of that Act and Rule 10b-5 (17 C. F. R. 240, 10b-5) thereunder, and those based on violations of NASD Rules of Fair Practice should be stricken; and that all claims under Section 17 of the Securities Act of 1933 should be stricken; and the Court has also examined and considered Memorandum in Support of Certain Defendants' Motion to Strike Certain Allegations of the Complaint; Plaintiff's Memorandum in Opposition to Defendants' Motion to Strike Certain Allegations of the Complaint; and the Defendants' Reply Memorandum in Support of Motion to Strike Certain Allegations of the Complaint, and the Court is of the opinion that said Motion to Strike Certain Allegations of the Complaint filed by the Defendants is not well taken and should be denied, and that said Defendants should file their answer to said complaint within a short day.

Therefore, it is Ordered that the Motion to Strike Certain Allegations of the Complaint filed by the Defendants be and the same is hereby denied, and said Defendants be and they are hereby directed to file their answer to said complaint within 20 days from the date of this order.

Case called for status 9:30 November 20, 1970.

Dated: October 8, 1970.

/s/ J. S. PERRY,
Judge.

IN THE UNITED STATES DISTRICT COURT
For the Northern District of Illinois
Eastern Division.

HENRY T. SANDERS,
Plaintiff,
vs.
JOHN NUVEEN & Co., INC., et al.,
Defendants.
No. 70 C 597

AMENDED ORDER

The Court has examined and considered the Motion to Strike Certain Allegations of the Complaint filed by defendants wherein and whereby they request that the class allegations of the Complaint be stricken; that all claims under the Securities Exchange Act of 1934, which are those alleging violations of Section 10(b) [15 U. S. C. 77j(b)] and 20 [15 U. S. C. 78t] of that Act and Rule 10b-5 [17 C. F. R. 240. 10b-5] thereunder and those based on violations of NASD Rules of Fair Practice should be stricken; and that all claims under Section 17 of the Securities Act of 1933 should be stricken; and the Court has also examined and con-

sidered Memorandum in Support of Certain Defendants' Motion to Strike Certain Allegations of the Complaint; Plaintiff's Memorandum in Opposition to Defendants' Motion to Strike Certain Allegations of the Complaint; and the Defendants' Reply Memorandum in Support of Motion to Strike Certain Allegations of the Complaint, and the Court is of the opinion that said Motion to Strike Certain Allegations of the Complaint filed by the defendants is not well taken and should be denied, and that said defendants should file their Answer to said Complaint within a short day.

Therefore, it is ordered that the Motion to Strike Certain Allegations of the Complaint filed by the defendants be and the same is hereby denied.

Paragraph 2 of defendants' motion asked that all claims in the complaint predicated on the Securities Exchange Act of 1934 be dismissed. These allegations pertain to Section 10(b) of the Act, Rule 10b-5 issued by the Securities and Exchange Commission and to the rules of the National Association of Securities Dealers. Defendants assert that the commercial paper purchased by plaintiff and on which he predicates his claim for relief is not a security as defined in Section 3(a)(10) of the Securities Exchange Act of 1934. With respect to the issues raised by Paragraph 2 of defendants' motion, the Court is of the opinion that this order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation.

Dated: November 18, 1970.

ENTER:

/s/ J. S. PERRY,
Judge.

APPENDIX B.

STATUTORY APPENDIX.
SECURITIES ACT OF 1933.

SECTION 2. DEFINITIONS.

When used in this title, unless the context otherwise requires—

(1) the term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

SECTION 3. EXEMPTED SECURITIES.

(a) Except as hereinafter expressly provided, the provisions of this title shall not apply to any of the following classes of securities:

• • • • •

(3) Any note, draft, bill of exchange, or bankers' acceptance, which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of

grace or any renewal thereof, the maturity of which is likewise limited.

SECTION 12. CIVIL LIABILITIES ARISING IN CONNECTION WITH PROSPECTUSES AND COMMUNICATIONS.

Any person who—

* * * * *

(2) offers or sells a security (whether or not exempted by the provisions of section 3, other than paragraph (2) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission

shall be liable to the person purchasing such security from him, who, may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

SECTION 17. FRAUDULENT INTERSTATE TRANSACTIONS.

(a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in inter-

state commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

SECTION 22. JURISDICTION OF OFFENSES AND SUITS.

(a) The district courts of the United States, the United States courts of any Territory, and the United States District Court for the District of Columbia shall have jurisdiction of offenses and violations under this title and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this title. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the offer [illegible] if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 225 and 347). No case arising under this title and brought in any State court of competent jurisdiction shall be removed to any court of the United States. No costs

shall be assessed for or against the Commission in any proceeding under this title brought by or against it in the Supreme Court or such other courts.

SECURITIES EXCHANGE ACT OF 1934.

SECTION 3. DEFINITIONS AND APPLICATION.

(a) When used in this title, unless the context otherwise requires—

• • • • •

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

SECTION 10. MANIPULATIVE AND DECEPTIVE DEVICES.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

• • • • •

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

SECTION 15A. OVER-THE-COUNTER BROKERS' AND DEALERS' ASSOCIATIONS; REGISTRATION.

(a) Any association of brokers or dealers may be registered with the Commission as a national securities association pursuant to subsection (b), or as an affiliated securities association pursuant to subsection (d), under the terms and conditions hereinafter provided in this section, by filing with the Commission a registration statement in such form as the Commission may prescribe, setting forth the information, and accompanied by the documents, below specified:

(1) Such data as to its organization, membership, and rules of procedure, and such other information as the Commission may by rules and regulations require as necessary or appropriate in the public interest or for the protection of investors; and

(2) Copies of its constitution, charter, or articles of incorporation or association, with all amendments thereto, and of its existing bylaws, and of any rules or instruments corresponding to the foregoing, whatever the name, hereinafter in this title collectively referred to as the "rules of the association."

Such registration shall not be construed as a waiver by such association or any member thereof of any constitutional right or of any right to contest the validity of any rule or regulation of the Commission under this title.

(b) An applicant association shall not be registered as a national securities association unless it appears to the Commission that—

(1) by reason of the number of its members, the scope of their transactions, and the geographical distribution of its members such association will be able to comply with the provisions of this title and the rules and regulations thereunder and to carry out the purposes of this section.

(2) such association is so organized and is of such a character as to be able to comply with the provisions of this title and the rules and regulations thereunder, and to carry out the purposes of this section.

(3) the rules of the association provide that any broker or dealer who makes use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security otherwise than on a national securities exchange, may become a member of such association, except such as are excluded pursuant to paragraph (4) or (5) of this subsection, or a rule of the association permitted under this paragraph. The rules of the association may restrict membership in such association on such specified geographical basis, or on such specified basis relating to the type of business done by its members, or on such other specified and appropriate basis, as appears to the Commission to be necessary or appropriate in the public interest or for the protection of investors and to carry out the purpose of this section. Rules adopted by the association may provide that the association may, unless the Commission directs otherwise in cases in which the Commission finds it appropriate in the public

interest so to direct, deny admission to or refuse to continue in such association any broker or dealer if—

(A) such broker or dealer, whether prior or subsequent to becoming such, or

(B) any person associated with such broker or dealer, whether prior or subsequent to becoming so associated,

has been and is suspended or expelled from a national securities exchange or has been and is barred or suspended from being associated with all members of such exchange, for violation of any rule of such exchange.

(4) the rules of the association provide that, except with the approval or at the direction of the Commission in cases in which the Commission finds it appropriate in the public interest so to approve or direct, no broker or dealer shall be admitted to or continued in membership in such association, if such broker or dealer—

(A) has been and is suspended or expelled from a registered securities association (whether national or affiliated) or from a national securities exchange or has been and is barred or suspended from being associated with all members of such association or from being associated with all brokers or dealers which are members of such exchange, for violation of any rule of such association or exchange which prohibits any act or transaction constituting conduct inconsistent with just and equitable principles of trade, or requires any act the omission of which constitutes conduct inconsistent with just and equitable principles of trade.

(B) is subject to an order of the Commission denying, suspending for a period not exceeding

twelve months, or revoking his registration pursuant to section 15 of this title, or expelling or suspending him from membership in a registered securities association or a national securities exchange, or barring or suspending him from being associated with a broker or dealer.

(C) whether prior or subsequent to becoming a broker or dealer, by his conduct while associated with a broker or dealer, was a cause of any suspension, expulsion, or order of the character described in clause (A) or (B) which is in effect with respect to such broker or dealer, and in entering such a suspension, expulsion, or order, the Commission or any such exchange or association shall have jurisdiction to determine whether or not any person was a cause thereof.

(D) has associated with him any person who is known, or in the exercise of reasonable care should be known, to him to be a person who, if such person were a broker or dealer, would be ineligible for admission to or continuance in membership under clause (A), (B), or (C) of this paragraph.

(5) the rules of the association provide that, except with the approval or at the direction of the Commission in cases in which the Commission finds it appropriate in the public interest so to approve or direct, no person shall become a member and no natural person shall become a person associated with a member, unless such person is qualified to become a member or a person associated with a member in conformity with specified and appropriate standards with respect to the training, experience, and such other qualifications of such person as the association finds necessary or desirable, and in the case of a

member, the financial responsibility of such member. For the purposes of defining such standards and the application thereof, such rules may—

(A) appropriately classify prospective members (taking into account relevant matters, including type of business done and nature of securities sold) and persons proposed to be associated with members.

(B) specify that all or any portion of such standards shall be applicable to any such class.

(C) require persons in any such class to pass examinations prescribed in accordance with such rules.

(D) provide that persons in any such class other than prospective members and partners, officers and supervisory employees (which latter term may be defined by such rules and as so defined shall include branch managers of members) of members, may be qualified solely on the basis of compliance with specified standards of training and such other qualifications as the association finds appropriate.

(E) provide that applications to become a member or a person associated with a member shall set forth such facts as the association may prescribe as to the training, experience, and other qualifications (including, in the case of an applicant for membership, financial responsibility) of the applicant and that the association may adopt procedures for verification of qualifications of the applicant.

(F) require any class of persons associated with a member to be registered with the association in accordance with procedures specified by

such rules (and any application or document supplemental thereto required by such rules of a person seeking to be registered with such association shall, for the purposes of subsection (a) of section 32 of this title, be deemed an application required to be filed under this title).

(6) the rules of the association assure a fair representation of its members in the adoption of any rule of the association or amendment thereto, the selection of its officers and directors, and in all other phases of the administration of its affairs.

(7) the rules of the association provide for the equitable allocation of dues among its members, to defray reasonable expenses of administration.

(8) the rules of the association are designed to prevent fradulent and manipulative acts and practices, to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and, in general, to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market; and are not designed to permit unfair discrimination between customers or issuers, or brokers or dealers, to fix minimum profits, to impose any schedule of prices, or to impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges.

(9) the rules of the association provide that its members and persons associated with its members shall be appropriately disciplined, by expulsion, suspension, fine, censure, or being suspended or barred from being associated with all members, or any other fitting penalty, for any violation of its rules.

(10) the rules of the association provide a fair and orderly procedure with respect to the disciplining of

members and persons associated with members and the denial of membership to any broker or dealer seeking membership therein or the barring of any person from being associated with a member. In any proceeding to determine whether any member or other person shall be disciplined, such rules shall require that specific charges be brought; that such member or person shall be notified of, and be given an opportunity to defend against, such charges; that a record shall be kept; and that the determination shall include—

(A) a statement setting forth any act or practice in which such member or other person may be found to have engaged, or which such member or other person may be found to have omitted.

(B) a statement setting forth the specific rule or rules of the association of which any such act or practice, or omission to act, is deemed to be in violation.

(C) a statement whether the acts or practices prohibited by such rule or rules, or the omission of any act required thereby, are deemed to constitute conduct inconsistent with just and equitable principles of trade.

(D) a statement setting forth the penalty imposed.

In any proceeding to determine whether a broker or dealer shall be denied membership or whether any person shall be barred from being associated with a member, such rules shall provide that the broker or dealer or person shall be notified of, and be given an opportunity to be heard upon, the specific grounds for denial or bar which are under consideration; that a record shall be kept; and that the determination shall

set forth the specific grounds upon which the denial or bar is based.

(11) the requirements of subsection (c), insofar as these may be applicable, are satisfied.

(12) the rules of the association include provisions governing the form and content of quotations relating to securities sold otherwise than on a national securities exchange which may be disseminated by any member or any person associated with a member, and the persons to whom such quotations may be supplied. Such rules relating to quotations shall be designed to produce fair and informative quotations, both at the wholesale and retail level, to prevent fictitious or misleading quotations, and to promote orderly procedures for collecting and publishing quotations.

The provisions of this subsection, as in effect prior to the date of enactment of the Securities Acts Amendments of 1964, shall be applicable to the rules of any registered securities association which was registered on such date until July 1, 1964. After July 1, 1964, the Commission may, after notice and opportunity for hearing, suspend the registration of any such association if it finds that the rules thereof do not conform to the requirements of this subsection, as amended by section 7 of the Securities Acts Amendments of 1964, and any such suspension shall remain in effect until the Commission issues an order determining that such rules have been modified to conform with such requirements.

(c) The Commission may permit or require the rules of an association applying for registration pursuant to subsection (b), to provide for the admission of an association registered as an affiliated securities association, pursuant to subsection (d), to participation in said applicant association as an affiliate thereof, under terms permitting

such power and responsibilities to such affiliates, and under such other appropriate terms and conditions, as may be provided by the rules of said applicant association, if such rules appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors and to carry out the purposes of this section. The duties and powers of the Commission with respect to any national securities association or any affiliated securities association shall in no way be limited by reason of any such affiliation.

(d) An applicant association shall not be registered as an affiliated securities association unless it appears to the Commission that—

(1) such association, notwithstanding that it does not satisfy the requirements set forth in paragraph (1) of subsection (b), will, forthwith upon the registration thereof, be admitted to affiliation with an association registered as a national securities association pursuant to said subsection (b), in the manner and under the terms and conditions provided by the rules of said national securities association in accordance with subsection (c); and

(2) such association and its rules satisfy the requirements set forth in paragraphs (2) to (10), inclusive, and paragraph (12), of subsection (b); except that in the case of any such association any restrictions upon membership therein of the type authorized by paragraph (3) of subsection (b) shall not be less stringent than in the case of the national securities association with which such association is to be affiliated.

(e) Upon the filing of an application for registration pursuant to subsection (b) or subsection (d), the Commission shall by order grant such registration if the require-

ments of this section are satisfied. If, after appropriate notice and opportunity for hearing, it appears to the Commission that any requirement of this section is not satisfied, the Commission shall by order deny such registration. If any association granted registration as an affiliated securities association pursuant to subsection (d) shall fail to be admitted promptly thereafter to affiliation with a registered national securities association, the Commission shall revoke the registration of such affiliated securities association.

(f) A registered securities association (whether national or affiliated) may, upon such reasonable notice as the Commission may deem necessary in the public interest or for the protection of investors, withdraw from registration by filing with the Commission a written notice of withdrawal in such form as the Commission may by rules and regulations prescribe. Upon the withdrawal of a national securities association from registration, the registration of any association affiliated therewith shall automatically terminate.

(g) If any registered securities association (whether national or affiliated) takes any disciplinary action against any member thereof or any person associated with such a member or denies admission to any broker or dealer seeking membership therein, or bars any person from being associated with a member, such action shall be subject to review by the Commission, on its own motion, or upon application by any person aggrieved thereby filed within thirty days after such action has been taken or within such longer period as the Commission may determine. Application to the Commission for review, or the institution of review by the Commission on its own motion, shall operate as a stay of such action until an order is issued upon such review pursuant to subsection (h), unless the Commission

otherwise orders after notice and opportunity for hearing on the question of a stay (which hearing may consist solely of affidavits and oral arguments).

(h)(1) In a proceeding to review disciplinary action taken by a registered securities association against a member thereof or a person associated with a member, if the Commission, after appropriate notice and opportunity for hearing, upon consideration of the record before the association and such other evidence as it may deem relevant—

(A) finds that such member or person has engaged in such acts or practices, or has omitted such act, as the association has found him to have engaged in or omitted, and

(B) Determines that such acts or practices, or omission to act, are in violation of such rules of the association as have been designed in the determination of the association,

the Commission shall by order dismiss the proceeding, unless it appears to the Commission that such action should be modified in accordance with paragraph (2) of this subsection. The Commission shall likewise determine whether the acts or practices prohibited, or the omission of any act required, by any such rule constitute conduct inconsistent with just and equitable principles of trade, and shall so declare. If it appears to the Commission that the evidence does not warrant the finding required in clause (A), or if the Commission determines that such acts or practices as are found to have been engaged in are not prohibited by the designated rule or rules of the association, or that such act as is found to have been omitted is not required by such designated rule or rules, the Commission shall by order set aside the action of the association.

(2) If, after appropriate notice and opportunity for hearing, the Commission finds that any penalty imposed

upon a member or person associated with a member is excessive or oppressive, having due regard to the public interest, the Commission shall by order cancel, reduce, or require the remission of such penalty.

(3) In any proceeding to review the denial of membership in a registered securities association or the barring of any person from being associated with a member, if the Commission, after appropriate notice and hearing, and upon consideration of the record before the association and such other evidence as it may deem relevant, determines that the specific grounds on which such denial or bar is based exist in fact and are valid under this section, the Commission shall by order dismiss the proceeding; otherwise, the Commission shall by order set aside the action of the association and require it to admit the applicant broker or dealer to membership therein, or to permit such person to be associated with a member.

(i) (1) The rules of a registered securities association may provide that no member thereof shall deal with any nonmember broker or dealer (as defined in paragraph (2) of this subsection) except at the same prices, for the same commissions or fees, and on the same terms and conditions as are by such member accorded to the general public.

(2) For the purposes of this subsection, the term "nonmember broker or dealer" shall include any broker or dealer who makes use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security otherwise than on a national securities exchange, who is not a member of any registered securities association, except a broker or dealer who deals exclusively in commercial paper, bankers' acceptances, or commercial bills.

(3) Nothing in this subsection shall be so construed or applied as to prevent any member of a registered securities association from granting to any other member of any

registered securities association any dealer's discount, allowance, commission, or special terms.

(j) Every registered securities association shall file with the Commission in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, copies of any changes in or additions to the rules of the association, and such other information and documents as the Commission may require to keep current or to supplement the registration statement and documents filed pursuant to subsection (a). Any change in or addition to the rules of a registered securities association shall take effect upon the thirtieth day after the filing of a copy thereof with the Commission, or upon such earlier date as the Commission may determine, unless the Commission shall enter an order disapproving such change or addition; and the Commission shall enter such an order unless such change or addition appears to the Commission to be consistent with the requirements of subsection (b) and subsection (d).

(k) (1) The Commission is authorized by order to abrogate any rule of a registered securities association, if after appropriate notice and opportunity for hearing, it appears to the Commission that such abrogation is necessary or appropriate to assure fair dealing by the members of such association, to assure a fair representation of its members in the administration of its affairs or otherwise to protect investors or effectuate the purposes of this title.

(2) The Commission may in writing request any registered securities association to adopt any specified alteration of or supplement to its rules with respect to any of the matters hereinafter enumerated. If such association fails to adopt such alteration or supplement within a reasonable time, the Commission is authorized by order to alter or supplement the rules of such association in the manner

theretofore requested, or with such modifications of such alteration or supplement as it deems necessary if, after appropriate notice and opportunity for hearing, it appears to the Commission that such alteration or supplement is necessary or appropriate in the public interest or for the protection of investors or to effectuate the purposes of this section, with respect to—

(A) the basis for, and procedure in connection with, the denial of membership or the barring from being associated with a member or the disciplining of members or persons associated with members, or the qualifications required for members or natural persons associated with members or any class thereof.

(B) the method for adoption of any change in or addition to the rules of the association.

(C) the method of choosing officers and directors.

(D) affiliation between registered securities associations.

(l) The Commission is authorized, if such action appears to it to be necessary or appropriate in the public interest or for the protection of investors or to carry out the purposes of this section—

(1) after appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to revoke the registration of a registered securities association, if the Commission finds that such association has violated any provision of this title or any rule or regulation thereunder, or has failed to enforce compliance with its own rules, or has engaged in any other activity tending to defeat the purposes of this section.

(2) after appropriate notice and opportunity for hearing, by order to suspend for a period not exceed-

ing twelve months or to expel from a registered securities association any member thereof, or to suspend for a period not exceeding twelve months or to bar any person from being associated with a member thereof, if the Commission finds that such member or person—

(A) has violated any provision of this title or any rule or regulation thereunder, or has effected any transaction for any other person who, he had reason to believe, was violating with respect to such transaction any provision of this title or any rule or regulation thereunder.

(B) has willfully violated any provision of the Securities Act of 1933, as amended, or of any rule or regulation thereunder, or has effected any transaction for any other person who, he had reason to believe, was willfully violating with respect to such transaction any provision of such Act or rule or regulation.

(3) after appropriate notice and opportunity for hearing, by order to remove from office any officer or director of a registered securities association who, the Commission finds, has willfully failed to enforce the rules of the association, or has willfully abused his authority.

(m) Nothing in this section shall be construed to apply with respect to any transaction by a broker or dealer in any exempted security.

(n) If any provision of this section is in conflict with any provision of any law of the United States in force on the date this section takes effect, the provision of this section shall prevail.

SECTION 20. LIABILITIES OF CONTROLLING PERSONS.

(a) Every person who, directly or indirectly, controls any person liable under any provision of this title or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

(b) It shall be unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the provisions of this title or any rule or regulation thereunder through or by means of any other person.

(c) It shall be unlawful for any director or officer of, or any owner of any securities issued by, any issuer required to file any document, report, or information under this title or any rule or regulation thereunder without just cause to hinder, delay, or obstruct the making or filing of any such document, report, or information.

SECTION 27. JURISDICTION OF OFFENSES AND SUITS.

The district courts of the United States, the United States District Court for the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the

violation occurred. Any suit or action to enforce any liability or duty created by this title or rules and regulations thereunder, or to enjoin any violation of such title or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 225 and 347). No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against it in the Supreme Court or such other courts.

Title 28, United States Code.

SECTION 1292. INTERLOCUTORY DECISIONS.

* * * * *

(b) When a district judge, in making in a civil action an order not otherwise appealable under this section, shall be of the opinion that such order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation, he shall so state in writing in such order. The Court of Appeals may thereupon, in its discretion, permit an appeal to be taken from such order, if application is made to it within ten days after the entry of the order: *Provided, however,* that application for an appeal hereunder shall not stay proceedings in the district court unless the district judge or the Court of Appeals or a judge thereof shall so order.

General Rules and Regulations of the Securities and Exchange Commission Under the Securities Exchange Act of 1934.

Rule 10b-5. Employment of Manipulative and Deceptive Devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person in connection with the purchase of sale of any security.

Rules of Fair Practice of the National Association of Securities Dealers, Inc., Article III.

Section 2. Recommendations to Customers.

In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs.

Section 18. Use of Fraudulent Devices.

No member shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance.

Section 27. Supervision.

Written procedures

(a) Each member shall establish, maintain and enforce written procedures which will enable it to supervise properly the activities of each registered representative and associated person to assure compliance with applicable securities laws, rules, regulations and statements of policy promulgated thereunder and with the rules of this Association.

Responsibility of member

(b) Final responsibility for proper supervision shall rest with the member. The member shall designate a partner, officer or manager in each office of supervisory jurisdiction, including the main office, to carry out the written supervisory procedures. A copy of such procedures shall be kept in each such office.

Written approval

(c) Each member shall be responsible for keeping and preserving appropriate records for carrying out the member's supervisory procedures. Each member shall review and endorse in writing, on an internal record, all transactions and all correspondence of its registered representatives pertaining to the solicitation or execution of any securities transaction.

Review of activities and annual inspection

(d) Each member shall review the activities of each office, which shall include the periodic examination of customer accounts to detect and prevent irregularities or abuses and at least an annual inspection of each office of supervisory jurisdiction.

Qualifications investigated

(e) Each member shall have the responsibility and duty to ascertain by investigation the good character, business repute, qualifications and experience of any person prior to making such a certification in the application of such person for registration with this Association.

"Office of supervisory jurisdiction"

(f) "Office of supervisory jurisdiction" means any office designated as directly responsible for the review of the activities of registered representatives or associated persons in such office and/or in other offices of the member.